VIII Financing Infrastructure for the 21st Century

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TOP: METRO RAPID BUS, LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY
MIDDLE: BAY AREA,CALIFORNIA DEPARTMENT OF TRANSPORTATION
BOTTOM: VALENCIA, CALIFORNIA, LOCAL GOVERNMENT COMMISSION

This report has documented the effects of our accumulated infrastructure deficit. The Davis administration, the Legislature and the people of California have begun to reverse the decline through a substantial increase in infrastructure investment. However, existing revenue sources will not meet current and projected needs due to increasing costs for maintenance, repair, and new infrastructure development, the expiration of local sales taxes, and the erosion of other existing revenue streams, such as gasoline taxes.

Californians will need to significantly increase and sustain infrastructure investments to implement the recommendations of the Commission and prepare for our future. In addition, we will need to improve how we plan for and coordinate these investments to obtain the greatest leverage and achieve the greatest impact.

Cost-reduction strategies must be implemented, existing revenue streams must be maintained and enhanced and, when necessary, new revenue sources must be created to ensure sustained funding. Investments must be targeted and leveraged with equity and efficiency to achieve the best use of limited resources. Planning must be coordinated across public and private sectors.

Proposed Investment Criteria

The Commission developed criteria to guide decision-makers in optimizing finite investment resources within the framework of the Commission's Guiding Principles:

- **MAXIMIZE RETURN ON EXISTING INFRASTRUCTURE INVESTMENT**
  Protect our existing infrastructure by investing in both deferred maintenance and modernization; use technology, expansions, upgrades, and techniques such as demand management and conservation strategies.
- **STRIVE FOR MAXIMUM LEVERAGE OF EVERY STATE DOLLAR SPENT**
  Augment the value of State funds by leveraging those funds whenever possible and by stimulating the investment of other resources through contributions, matches and explicit public-private investment partnerships.
- **IMPLEMENT INTEGRATED INFRASTRUCTURE STRATEGIES**
  Use financing methods that serve crosscutting or multiple rather than single-purpose needs. The State's direct funding of infrastructure must be fully coordinated with regional and local infrastructure spending.

Recommended Options

The Commission proposes five major funding strategies for addressing the State's immediate infrastructure challenges and providing a framework for a long-term investment strategy. These strategies must be used in combination in order to fully meet our needs. They are described below:

"California's leaders have come together to focus on the infrastructure needs of the State. This report sends a clear message that California is once again OPEN for business."

Keith Brackpool
Commissioner
Cadiz Incorporated
June 2001

1. CREATION OF THE CALIFORNIA INFRASTRUCTURE FUND

Establish a permanent infrastructure investment fund separate and distinct from those funds currently earmarked or budgeted for infrastructure. For much of the past 40 years, infrastructure funding has been uncertain and unreliable. This Fund would require a yearly set-aside appropriation from the General Fund. With an annual appropriation initially of at least 1% of General Fund revenues, assuming growth of at least 5% annually in the General Fund, the result could be a commitment of approximately $5 to $10 billion for infrastructure projects over 10 years, beyond the requirements of existing law. The goal should be to increase the General Fund commitment over time to ensure a permanent revenue stream. Annual and long term priorities for investments from the Fund would be determined through the budget process to enable the Governor and the Legislature to respond flexibly to changing infrastructure needs and priorities.

The Commission acknowledges that this set-aside would decrease the proportion of the discretionary budget available to meet non-infrastructure needs, but believes that this commitment is essential to assure that we do not continue our infrastructure deficit. In the event of an economic slowdown or recession, and General Fund revenues fall below 5% growth, a trigger mechanism could temporarily suspend this set-aside requirement.

PHOTO CREDIT: CALIFORNIA TECHNOLOGY, TRADE AND COMMERCE AGENCY

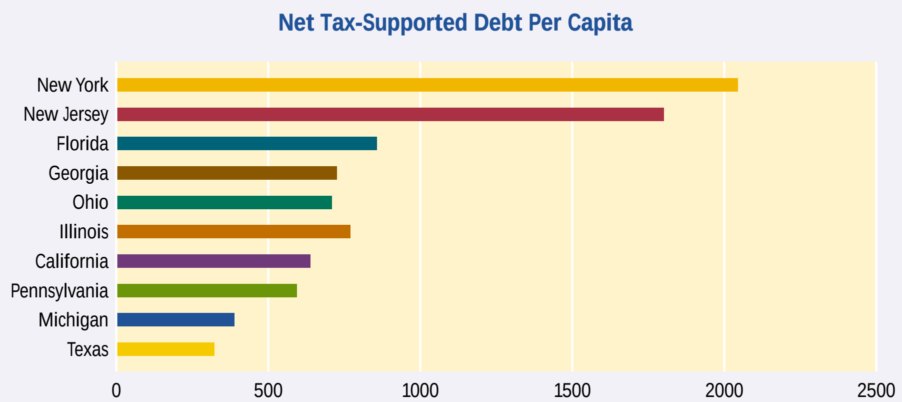
San Diego, California

“The actual amount of debt the State can afford to issue will depend on the performance of the economy, thus underscoring the importance of infrastructure investment strategies that sustain economic growth. Debt capacity also will be affected by any changes in expenditure demands on the State’s revenues.”

“California’s 2000 Debt Affordability Report,” Office of the State Treasurer

2. INCREASED USE OF GENERAL OBLIGATION BONDS

The issuance of additional debt will be necessary to support Commission recommendations in specific infrastructure areas, such as school construction. When deemed financially prudent by the Office of the State Treasurer and the California Department of Finance, additional bonds should be issued whose funds are earmarked for future infrastructure projects. Credit rating agencies often view 6% as the maximum desirable allocation of General Fund revenues to debt principal and interest repayment. At the time of this writing, the State is operating at a debt ratio at nearly 4%. The State Treasurer’s Office estimates that at the current ratio, the State can support approximately $39 billion in general obligation debt over the next 10 years.



Source: “2001 State Debt Medians” Moody’s Investors Service, April 2001

If the State were to increase the percentage of General Fund revenue earmarked for debt service to 5% over the next five years, the amount of debt that could be supported would increase to approximately $54 billion. If the State increased its commitment to 6%, the amount of debt that could be supported would reach $69 billion. While it may not be practical or desirable to increase the debt service share of the State’s General Fund budget at present, the capacity should be consistently reviewed for future needs. This option was also noted in the California Department of Finance’s 1999 Capital Outlay and Infrastructure Report.

California is in a good position relative to other states in terms of net tax-supported debt, and could prudently increase its debt obligations. Based on data from Moody’s, California is 19th nationally and 7th lowest among the top 10 most populous states in terms of debt per capita.

PHOTO CREDIT: CALIFORNIA STATE UNIVERSITY, SONOMA

Jean and Charles Schulz Information Center housing the California State University, Sonoma Library and the Information Technology Services

3. ENHANCED PARTNERSHIPS

The State can maximize the potential for increased investments locally and regionally by using its role to leverage resources and link a broad range of partners. Acting as a facilitator, the State can:

The State of Florida partners with developers by offering a financial incentive to build infill projects and other developments that promote the greater use of public transit facilities and infrastructure.

- Encourage public-private partnerships across all infrastructure categories and projects, especially to leverage private and philanthropic investments. As an example, the State Treasurer has proposed the establishment of a State-chartered investment fund, the 21st Century Fund, that would invest in underserved, emerging markets in California. The fund would be capitalized with State General Fund monies to be matched with foundation and private funding. Research shows that $300 million in public investment over the next four years would leverage approximately $1.4 billion in private and philanthropic investment.
- Assist regions with projects of regional and national significance, such as the Alameda Corridor East, to obtain federal funding through the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) and various other innovative financing tools.
- Provide expanded technical assistance to local governments and agencies on cost-effective and innovative financing strategies.
- Partner with community and nonprofit organizations and the philanthropic community to maximize federal funding opportunities such as discretionary grants.

4. INNOVATIVE FINANCING STRATEGIES

These strategies are divided into two areas: maximizing the efficiency of current resources and developing new revenue streams. The implementation of these strategies must be fully aligned with the State Five-Year Capital Budget Planning process (AB 1473–see Option 5 for detail).

MAXIMIZE EFFICIENCY AND ALLOCATION OF AVAILABLE RESOURCES:

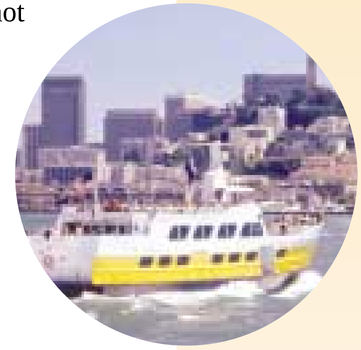
- Aggressively expand demand management and conservation programs. While many efficiencies have been realized, especially in the areas of water and energy use, far greater savings can be achieved. Real-time pricing and other mechanisms can be explored for managing demand for many types of infrastructure, including transportation, especially during peak hours of use.

Arkansas, Massachusetts, New Jersey, New Mexico and Ohio have leveraged federal funds by issuing Grant and Revenue Anticipation Vehicles (GARVEE bonds) to finance transportation projects.

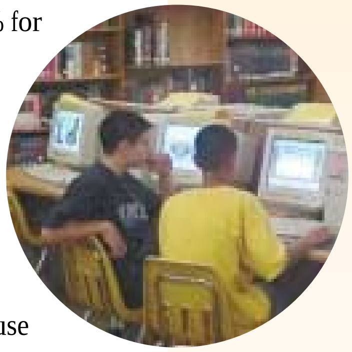
- Optimize the efficiency and effectiveness of federal dollars by issuing grant anticipation notes (GANs) whenever possible. In addition, the State should seek opportunities to use large, regularly anticipated federal grants to securitize new bonds.
- Revise the state-local fiscal relationship. (See the Housing and Land Use categories for description.) This strategy would result in more housing production and would support more effective regional and cross-jurisdictional planning and investment collaboration, which would lower infrastructure costs in the future.
- Aggressively pursue California's fair share of federal assistance programs in general and, in particular, for targeted funds for projects of regional and national significance such as the CALFED water project.
- Identify new options to sell bonds backed by guaranteed future revenue sources. Many states have found innovative ways to develop new bond capacity out of existing resources. For example, the states of Alabama and Alaska successfully securitized their tobacco settlement funds.
- Increase experimentation in the management of infrastructure financing and delivery mechanisms. For example, the California Infrastructure and Economic Development Bank can establish a continuous process for assessment of criteria for project eligibility.
- Revisit the concept of Infrastructure Financing Districts (IFDs). IFDs are taxing districts that allow for the use of tax increment financing for specified public improvements on substantially rural or undeveloped land. Authorized under California State Law since 1990, there has only been one such district formed. The minimal use of IFD statute is largely due to the significant lag time between the formation of such a district and the point at which that district's tax base can begin to pay for itself.

EXPLORE NEW REVENUE STREAMS:

The Commission again makes note that our State faces its infrastructure challenges without enough resources to meet current or future needs. Even many existing revenue streams cannot be counted upon for the long term. For that reason, we do not feel that we will have done our job without the recognition that new or expanded revenue streams—fees, taxes or the sale and/or lease of assets—should be part of the ongoing public debate on how we provide for our infrastructure needs. Any revenues from such mechanisms should be dedicated to infrastructure development. The Commission has debated a wide range of options. The following could be explored by local and state policymakers and stakeholders.



- Local Revenue Voter Threshold: The Governor and Legislature should support passage of a constitutional amendment to lower the voter threshold to 55% for local bonds and sales tax initiatives to generate revenues for local and regional infrastructure projects. This reform is especially urgent for local transportation agencies whose sales tax revenue may soon expire.



- Access Fees: To the extent allowable under federal law, particularly Section 253 of the Telecommunications Act of 1996, the development of new revenue streams from the telecommunications industry based on the use of the State's rights of way should be considered, as long as such policy meets with California's goal to accelerate deployment of advanced telecommunication services to all Californians. Additionally, in an effort to capture revenue lost by local government entities as a result of increased use of satellite technologies to provide broadcast and telecommunication services, the State should consider developing new revenue streams by deploying similar fee structure upon those providers.

- A Dedicated "Infrastructure Fee" on Car Rentals: While California does impose a vehicle license fee on car rentals of $1.95 per day on top of a flat 8% sales tax, the cost of renting a car in California is actually lower than it is in many other states.
- Radio Spectrum Rights: Most school districts and universities use only a portion of their FCC-allocated bandwidth. Some have been leasing their excess bandwidth to large telecommunications companies, although there is some question as to whether they are receiving fair market value for this coveted asset. Additional research is needed to determine the feasibility of the State forming a "Spectrum Rights Authority," whereby participating school districts and universities could pool their available bandwidth and lease or sell those assets en masse to the highest bidder.

PHOTO CREDITS:
TOP: SAN FRANCISCO, CALIFORNIA, BLUE AND GOLD FLEET
MIDDLE: CHICO UNIFIED SCHOOL DISTRICT
BOTTOM: T. PARKER/AICP

- Charge on Automobiles and Automotive Parts: One possible method to compensate for the projected erosion of fuel tax revenue is to place an infrastructure charge on automobiles and automotive parts. Based on 1999 data from the California State Board of Equalization, a 1% charge added to new and used automobile sales could yield $446 million dollars per year.

The State of Vermont levies a statewide real property transfer tax on the purchase price of property other than a purchaser's principal residence, as well as a tax on the purchase of a principal residence, at a rate differential.

- A State-Level, Real Property Transfer Tax: Presently, counties and cities throughout California levy a real property transfer tax at a modest rate. A state-level transfer tax could help reduce what may be a disproportionate burden on new homeowners and balance it with revenues from long-held properties.

PHOTO CREDIT: N. HANSON/CALIFORNIA ENERGY COMMISSION

Sacramento Memorial Auditorium retrofitted for seismic safety, accessibility and energy efficiency, Sacramento, California

5. CONSISTENCY AND COORDINATION WITH THE CAPITAL BUDGET PLANNING PROCESS

The State has embarked on a five-year strategic planning process for capital budget planning across state agencies, to be coordinated by the California Department of Finance, pursuant to the passage of AB 1473. To maximize state resources, infrastructure investments should be linked to the efficient and effective use of funds across infrastructure categories. Therefore, infrastructure investment planning should be consistent with and linked to the capital budget planning process as the basis for developing a long-term state investment plan. The process should ensure coordination across state agencies, and ensure that state policies used as the basis for investment decisions are consistent with one another.

"Planning and executing the joint use of public facilities—reducing the duplication of similar functions and services—is a smarter, better use of taxpayer money."

Joel Fox,
President Emeritus,
Howard Jarvis
Taxpayers Association

State Capital Budget Planning Process: Details of AB 1473

This bill, sponsored by Assemblymember Robert M. Hertzberg and signed by the Governor in 1999, requires that the State submit an annual five-year proposed capital improvement plan to the Legislature that includes proposed capital improvement projects and their proposed funding sources, beginning in 2002. The plan must contain:

- **Identification of infrastructure needs requested by agencies**
- **Aggregate funding for transportation**
- **Infrastructure needs for K-12**
- **Instructional facility needs for U.C., C.S.U. and the Community Colleges**
- **The cost of providing infrastructure, sources of funding, and the impact on the State's debt position**

The plan does not need to specify projects for funding but may recommend "the type and quantity of infrastructure to be funded." The goal is to require state policymakers to undertake a comprehensive review of California's capital facilities needs, establish a clear set of priorities, and adopt an annual plan to serve as a budget blueprint for financing those priorities over the next decade. The bill replaces an existing requirement for the Director of Finance to prepare an annual report on major capital outlays. It is intended to complement the approval of individual capital projects through the existing budget process.